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CHARLES ELMORE
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No. 92

In the Supreme Court of the United States

OCTOBER TERM, 1929

ROBERT H. LUCAS AS COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

NORTH TEXAS LUMBER COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	3
Specification of errors to be urged	4
Summary of argument	4
Argument	5
Conclusion	12

CITATIONS

Cases:

American National Co. v. *United States*, 274 U. S. 99 ... 6, 8, 9, 11

Bedell v. *Commissioner of Internal Revenue*, 30 F. (2d) 622 .. 9

Clifton v. *Charles*, 53 Tex. Civ. App. 448 ... 8

Gober v. *Hart*, 36 Tex. 139 ... 8

Montgomery v. *Wise*, 138 Mo. App. 176 ... 8

Perry v. *Rice*, 10 Tex. 367 ... 7

United States v. *Anderson*, 269 U. S. 422 ... 6, 11

Statutes:

Revenue act of 1916, c. 463, sec. 13 (d), 39 Stat. 756, 771 .. 3, 5

Revenue act of 1917, c. 63, sec. 1200, 40 Stat. 300, 329 2

Miscellaneous:

Thompson on Real Property, vol. 5, sec. 4275 ... 7

2 C. B. 78 ... 7

2 C. B. 84 ... 7

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OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 16–17) is reported in 7 B. T. A. 1193. That of the United States Circuit Court of Appeals for the Fifth Circuit (R. 31–32) is reported in 30 F. (2d) 680.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 15, 1929. (R. 32.) Petition for writ of certiorari was filed on May 14, 1929, and the petition was granted October 14, 1929. (R.

34.) The jurisdiction of this Court is based upon Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Was the profit from the sale of the lands of the respondent, maintaining its accounts upon the accrual basis, derived in the year 1916, when a contract to sell was entered into, or in the year 1917, when the sale was consummated?

STATUTES INVOLVED

The pertinent parts of the Revenue Acts of 1916 and 1917 are as follows:

Act of October 3, 1917, c. 63, 40 Stat. 300, 329:

> SEC. 1200. That subdivision (a) of section two of such Act of September eighth, nineteen hundred and sixteen, is hereby amended to read as follows:
>
> "(a) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income, derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or

profits and income derived from any source whatever."

Act of September 8, 1916, c. 463, 39 Stat. 756, 771:

SEC. 13. (d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;

* * * * *

STATEMENT

The facts as found by the Board of Tax Appeals are as follows:

The respondent on December 27, 1916, granted a ten-day option to the Southern Pine Lumber Company to purchase its timberlands for a certain price. (R. 13–15.) The title to the property was examined on the same day and found to be satisfactory to the buyer. (R. 15.) On December 29, 1916, the Southern Pine Lumber Company arranged for a loan from a bank and telegraphed the respondent that it would exercise the option and would pay over the money as soon as the papers were prepared. Respondent thereupon ceased its operations on the property and withdrew its men who were working on the property. The written

instruments which were required to complete the transfer were delivered on January 5, 1917, and the purchase price paid on that date. (R. 15.) The respondent liquidated its business in 1917 subsequent to disposal of the timberland. (R. 13.)

The Southern Pine Lumber Company was amply solvent, ready and willing to carry out the contract of sale. (R. 15.)

The respondent kept its books upon an accrual basis. (R. 13.)

The Board of Tax Appeals sustained the Commissioner's determination that the respondent's profit from the sale of its lands was realized in 1917 and was taxable for that year. (R. 15–17.) This decision was reversed by the Circuit Court of Appeals for the Fifth Circuit. (R. 32.)

SPECIFICATION OF ERRORS TO BE ARGUED

The Circuit Court of Appeals erred—

1. In reversing the decision of the Board of Tax Appeals.

2. In holding that the profits from the sale of respondent's lands accrued to it when the contract to sell was entered into and not when the sale was consummated.

SUMMARY OF ARGUMENT

The single question in this case is in what year the respondent company, maintaining its accounts upon the accrual basis, derived profits from a sale of its entire timberlands. Contract to sell was made in December, 1916, but no conveyance took

place until January, 1917. On the one hand, it may be contended that, as there was a binding contract to sell entered into during 1916, with the price agreed upon and the profits from the sale definitely ascertainable, the decisions of this Court in *United States* v. *Anderson,* 269 U. S. 422, and *American National Company* v. *United States,* 274 U. S. 99, necessitate the determination of this question in favor of the respondent. On the other hand, the Treasury Department has consistently ruled that in an executory contract to sell real property the right to payment does not become fixed upon the execution of the contract and income can not be said to have then accrued.

The interest of the Government is primarily to secure a determinative decision with respect to the question here involved. It is submitted that neither the *Anderson case* nor the *American National case* requires a disturbance of the settled practice of the Treasury Department.

ARGUMENT

Under Section 13 (d) of the Revenue Act of 1916 respondent was privileged to report its income on the basis upon which its accounts were kept, if such basis clearly reflected its income. Respondent in this case maintained its accounts upon the so-called "accrual" basis and accordingly has sought to return as income in 1916 the profits derived from the sale of all its timberlands.

It was not contested below that a binding contract to sell was entered into during the year 1916,

nor that title was satisfactory and the purchaser able and willing to carry out the sale. Upon these admitted facts the Circuit Court of Appeals has held that, under the accrual system of accounting followed by respondent, the profits from the sale were returnable as income in 1916.

As authority for its decision, the Circuit Court of Appeals has relied upon *United States* v. *Anderson*, 269 U. S. 422, and *American National Company* v. *United States*, 274 U. S. 99. In the *Anderson case* this Court held that munitions taxes for the year 1916 became fixed and determinable in that year, though not due until 1917, and sustained the decision of the Commissioner that a deduction for such taxes should be taken in 1916 rather than in 1917.

In discussing the accrual of the tax, the opinion in the *Anderson case* held (p. 441) that all of the events which fixed the amount of the tax and determined the liability of the taxpayer to pay it occurred in the earlier year. The Circuit Court of Appeals in the instant case has held that as between the parties the transaction was complete and their rights vested during the year 1916. (R. 32.)

On the one hand, it may be contended that, as there was a binding contract to sell entered into during 1916, with the price agreed upon and the profits from the sale definitely ascertainable, the profit should be deemed to have accrued in that year, within the principle of the *Anderson* decision. On the other hand, the view which the Treasury Department has taken is that in an executory con-

tract to sell real property the right to payment does not become fixed upon the execution of the contract, and income can not be said to have then accrued. Briefly stated, the position of the Department is that an agreement to sell is not a sale (see Thompson on Real Property, Vol. 5, Sec. 4275), and the profits are conditional upon consummation.

The decision of the Circuit Court of Appeals in this case is therefore contrary to the practice of the Treasury Department, which has long held that no profit is derived from a mere contract to sell real estate in the future. Early rulings, that gain or loss can be regarded as realized only when the sales are consummated (see C. B. 2, p. 78 (A. R. R. 13), C. B. 2, p. 84 (O. 988)), have been consistently applied to taxpayers on the accrual basis, as well as to those on the cash basis.

In the instant case the taxpayer had neither made nor tendered conveyance in 1916. The duty was upon the taxpayer to prepare the conveyance (*Perry* v. *Rice,* 10 Tex. 367), and the written instruments necessary to effect the transfer were not completed and delivered until 1917. (R. 4, 15.) It would further appear from the testimony of respondent's vice president and its counsel that the necessary papers of conveyance were of a character precluding their completion in 1916. (R. 23, 27–28.

The covenants of the vendor to convey, and the covenants of the vendee to pay the purchase money, were mutual and reciprocal. The contract in the in-

stant case merely provided for the payment of the purchase price on the one hand and the conveyance of the property on the other; no time was fixed for either, and nothing was specified as to the relations of the two acts. (R. 13–15.) Under such state of facts, the right to the purchase price was conditional. Before the taxpayer could be unconditionally entitled to the purchase price, which would include its profits, conveyance or tender thereof was necessary. *Montgomery* v. *Wise,* 138 Mo. App. 176; *Gober* v. *Hart,* 36 Tex. 139; *Clifton* v. *Charles,* 53 Tex. Civ. App. 448.

In the *American National Company case, supra,* also cited by the Circuit Court of Appeals, the taxpayer was in the business of making loans secured by mortgages upon real estate which it negotiated and sold to investors. It derived its income from commissions in the form of notes made by the borrowers, and, in order to induce purchasers of the notes to buy direct from the company, thus obviating the payment of selling commissions, agreed to pay the purchasers bonuses of a specified percentage yearly on the notes and during the life thereof. The taxpayer accrued the aggregate of the bonus contracts made during the year as expenses thereof and also followed the practice of accruing the aggregate of the commission notes received during a tax year as income, thus effecting the balancing of accounts and the true reflection of income. Upon these facts it was held that the bonus contracts were rightly treated by the taxpayer as " 'an

expense incurred and properly attributable' to the Company's process of earning income during'' the taxable year.

It is clear that in the *American National Company case,* the bonus contracts became actual and enforceable liabilities of the maker in the year in which given, although payment was not then due. In that case all the events which fixed the liability had occurred within the year in question. In the instant case, there did not in 1916 exist a right enforceable within that year, as the respondent had not made or tendered conveyance. It is true that the amount which the respondent in this case would derive from the sale was definitely ascertainable when the contract to sell was entered into, but payment might never have been made, for a breach, rescission, or release might have occurred, and the title might never have been conveyed.

In the case of *Bedell* v. *Commissioner of Internal Revenue,* 30 F. (2d) 622, the Circuit Court of Appeals for the Second Circuit held, *inter alia,* that the gain from a transaction involving the purchase and resale of a building was income in the year in which title passed and not in the year the contract of sale was made. It was there said (p. 624):

> we do not understand that the appellant maintains that a contract of sale would measure the profit before the time of payment; at any rate it is clear that it would not. While equity regards a vendee before payment as owner, still the payment is for the title, and is conditional on its delivery, as

> much as in the case of chattels where title has not passed. Of course, it is true that an obligation, even a conditional obligation, is in some sense property, and like anything else that can be transferred, may be said to have a value, but nevertheless payment is made in exchange for title, and will never be made if it is not conveyed. To speak of the profit as resulting because the amount can be presently ascertained, though performance remains uncertain, seems to us a perversion of language.

In the foregoing case the taxpayer was on the cash receipts and disbursements basis, but in a general way the above quotation expresses the reasons which underlie the Treasury Department's rule that profits from sales of realty can not be accrued until conveyance is made.

So far as we have been able to ascertain, the instant case is the only decision of an appellate court passing directly upon the question as to when profits from the sale of realty are returnable as income in the case of a taxpayer on the accrual basis.

Unlike *United States* v. *Anderson, supra,* and *American National Company* v. *United States, supra,* no showing has been made in this case that the expenses connected with the sale of the property appear in the taxpayer's 1916 accounts as an offset to the income. Accordingly, there is no room for the contention here that a failure to allow the accrual of the profits in 1916 would result in a distortion of the taxpayer's income for that year.

The interest of the United States is not to win this case but to have a rule adopted for general application to sales of real property which would be sound and consistent with the statute. The affirmance of the decision of the court below would overturn a long administrative construction of the Revenue Acts. We submit that neither the *Anderson case* nor the *American National case, supra,* requires this.

CONCLUSION

It is deemed important that a determinative decision be rendered with respect to the question here involved. The case is therefore submitted for the judgment of this Court.

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